Invest in Your Health Savings Account

Written by Justin Stevens

There is a better savings vehicle than all the others when it comes to savings for one important aspect of your retirement: health care. The Health Savings Account (HSA) provides savers with the best attributes of the IRA and the Roth IRA, tax-deferred contributions and tax-exempt distributions, making these accounts "triple-tax advantaged." In this article, I'll explain who's eligible for these accounts, how they work, and provide a long-term strategy to maximize the benefits of saving into an HSA.

More and more working Americans are seeing a transition to High Deductible Health Plans (HDHP) in their workplaces. These plans shift the responsibility of medical expenses from the insurance companies to individuals by lowering premiums and requiring the insured pay the first several thousand dollars of medical expenses out of pocket via a deductible. If you're working, chances are you've witnessed this shift and now need to plan for medical costs you once had covered by a co-pay plan.

To contribute to a Health Savings Account, you must be covered by a High Deductible Health Plan. This means retirees and anyone covered by Medicare benefits do not qualify. For those readers who are still working, the National Center for Health Statistics produced a study in August 2018 that showed Traditional Insurance Plan coverage dropped from 85% to 56.6%, with most employers shifting to HDHP. These trends are likely to continue as employers and insurance companies try to alleviate the increasing pressure of health care costs. If you're not covered by a HDHP today, chances are you might be in the next few years.

Health Savings Accounts are designed to accommodate individuals and families who transitioned to HDHP coverage and need a way to save money to cover their deductible. To incentivize this proactive behavior, the HSA offers a tax-deduction for all contributions and, if the funds are used for qualified medical expenses, the distributions are not taxed. If you withdraw the money for other uses, the money is taxable and is subject to a 20% penalty.

The Health Savings Account can be a short-term or a long-term option for individuals and families who will incur health expenses in the current year or in future years. Most people who deposit funds into their HSA, or receive employer contributions to their HSA, use those funds during the year contributions are made. Because the out-of-pocket deductible exists before any health insurance benefits are paid, these funds are needed to cover medical bills. The best solution in these scenarios is to use the Health Savings Account like a bank account with a debit card. The funds in the are readily available to cover a trip to the doctor or a prescription at the pharmacy.

Some individuals and families find that they do not need to spend all the money in their HSA and have a balance at the of the year. One major point of confusion is owners of HSA plans are familiar with the restrictive nature of Flexible Spending Accounts or FSAs. These plans require users to spend their account balance during the year, or risk losing the money at the end of the tax year. HSAs differ from FSAs because the remaining balance carries over to the next tax year, with no risk to the insured losing their contributions because they were not spent. If you have minimal expenses in the current year, the HSA is a great vehicle to build up a comfortable savings account to ensure you are always able to cover your out-of-pocked deductible.

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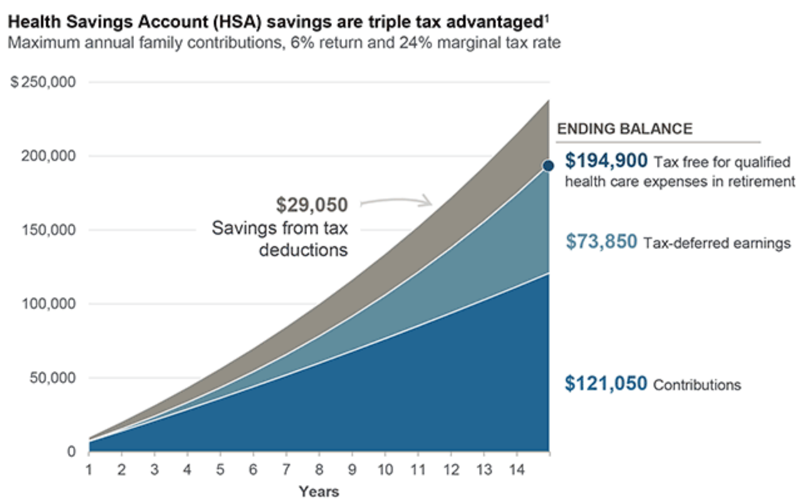
As HSA plan balances have increased, a third option is growing in popularity and is the focus of this article's attention. The ability to invest a portion of the HSA balance and grow a pool of resources available for retirement health expenses. Many plans now offer the ability to move funds from a savings account to an investment account with minimal costs and a variety of long-range investment solutions. Chances are your employer-sponsored plan offers this option. If you have selected your own Health Savings provider, you can check and see if the option exists on your current platform. We're excited because TD Ameritrade has become the partner of choice for many HSA providers and offers the option to host your investments on the platform where you maintain your other long-term savings accounts.

The strategy we recommend for people who can save extra dollars towards their future is to utilize a Health Savings Account with ability to invest in long-term savings vehicles like stocks or mutual funds. For most people, it will probably make sense to maintain a cash balance in the HSA equivalent to your out-of-pocket maximum deductible in a given year. Any additional resources in the HSA should be invested and left to grow. These funds can be used as a health care specific lot of tax-free dollars in retirement years.

An advanced solution for individuals and families who want to maximize this opportunity also exists. If you're financially able to save the full $7,000/family or $3,500/individual into the health savings account and invest it fully, these plans can produce an outstanding return on investment because of the tax-free nature of the HSA. Check out the graph produced by JP Morgan's Guide to Retirement this year:



Source: JP Morgan

If you did not touch the balance of the Health Savings Account and maximized the $7,000/year family contribution for 15 years while earning 6%, you're $121,050 in contributions would grow to $194,900 of tax-free money, and you would have received $29,050 of tax savings during the 15 year period if you were in the 24% marginal tax bracket. If you're in the top tax bracket of 37% the tax savings are worth $44,790 over 15 years!

If you're able to do that kind of savings over 30 years and earn a 6% rate of return, the pool of money grows to over $500,000 and the tax savings are nearly $100,000. And, if you never touch the money for health expenses during your saving years, you can go back and reimburse yourself with tax-free dollars at any time in the future. For instance, a family might save $7,000 into the HSA during the course of the year and incur $5,000 of out-of-pocket expenses. Instead of using their HSA, the family could instead pay those expenses with after-tax dollars and keep track of their receipts for all medical related expenses each year. If that exact scenario played out every year for 30 years, the family would have $150,000 of unreimbursed medical expenses. The $500,000 account balance could be tapped to reimburse those expenses with completely tax-free dollars and the remaining $350,000 would be available for health care costs in retirement years.

There's a lot of moving parts here and we want to help you better understand this strategy. If you think it might be a good solution for your or someone you know, please reach out to us. We're familiar with the process of establishing the investment account within an HSA and can help you select appropriate investments. We also have strategies for managing the important record-keeping component of this multi-year strategy. We think it's a perfect opportunity for our HENRY (High-Earning, Not Rich Yet) clients, to build another pool of wealth with tax-free dollars.